

	economically at a wide range of locations for the purpose of wholesale leased lines interconnection.
Fair and coherent access pricing	The cost orientation obligation and the obligation to comply with charge controls should guarantee competitors that prices for wholesale leased lines is coherent with other services and gives the appropriate incentives for efficient investment decisions to both the SMP operator and its competitors.
Reasonable quality of access products	The proposed revisions of the SLAs/SLGs regime should deliver a much improved framework for dealing with the quality of the services provided by BT to its competitors.

Wholesale market for trunk segments in the UK

Introduction

- 8.309 In this sub Section, we set out the regulatory obligations that we impose on BT as a result of our finding that it has SMP in the provision of trunk segments in the UK.
- 8.310 We first provide a summary of the proposals as set out in the January 2008 consultation, which include a summary of the assessment of the appropriate policy options and remedies. Secondly, we review the responses to the consultations, providing our response to the issues raised therein. Thirdly, we review the choice of the appropriate remedies, having regard to all the responses and evidence available to us. We then set out our conclusions and the remedies we have decided to impose on BT.
- 8.311 The last part of this sub Section sets out how we believe our obligations comply with the relevant tests in the Act. In addition, we set out how we have taken into account the ERG WLL CP in setting our obligations.

Summary of proposals

- 8.312 In paragraphs 7.351 to 7.416 of the January 2008 consultation we set out our proposals in support of the finding of SMP for BT in this market. In Section 7, in paragraphs 7.163 to 7.177, we have now confirmed our proposed finding of SMP. In the table below, we set out the key findings in support of our view.

Table 8.13 Key market power indicators

	Wholesale trunk segments market
<i>Quantitative indicators</i>	
Market Share	58-86% (was above 50% in the 2003/04 Review ¹⁰²)
Profitability	67% ROCE (2007/08)
<i>Qualitative indicators</i>	
The ubiquity of BT's infrastructure and the fact that such infrastructure is not easily duplicated	

¹⁰² See paragraph 3.87 to 3.88, Final Statement and Notification, *Review of the retail leased lines, symmetric broadband origination and wholesale trunk segments*, June 2004.

BT's ability to exploit economies of scale and scope
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The existence of significant barriers to entry and expansion
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8.313 In paragraphs 8.268 to 8.358 of the January 2008 consultation we then reviewed the regulatory options available to us, identified which option we believed would most appropriately serve our policy objectives, and which remedies, if any, should apply to BT in relation to its proposed SMP determination in the provision of trunk segments. We present a summary of that assessment in the following paragraphs.

Options assessment

8.314 Before setting out our analysis of appropriate remedies, we considered the broad policy options available to us and how best we could meet our policy objectives in the light of the SMP finding and BT's persistently high share of this market. We considered two main policy options, namely keeping the existing regulation or varying it to address the shortcoming we had identified, against the counterfactual of not imposing any regulation at all. It is worth considering that trunk services are sold alongside terminating segments, and that some of the problems identified in relation to the other TISBO markets are common to trunk services as well. In the discussion below we therefore refer, where appropriate, to the discussion of the specific issue set out earlier in this Section in relation to the market for low bandwidth TISBO in the UK.

8.315 In the January 2008 consultation, we considered the following regulatory options:

- *No regulation;*
- *Status quo*, which means to continue to regulate BT's provision of trunk segments with the same SMP Conditions as set out in the 2003/04 Review; and
- *Variations and additional measures*, including: reviewing the SLA/SLGs regime; requiring BT to address flaws in the PPC regulatory accounting regime; encouraging BT to address the other obstacles to replicability identified in the 2006 review; and considering further the opportunity to impose charge controls.

8.316 For each option, we considered how well it would serve our policy objectives, how it would affect the development of competition in downstream retail markets, and the impact it would have on the various key stakeholders, including BT.

8.317 The 2003/04 Review concluded that BT had SMP in this market for the duration of that review, but that in future we should expect a competitive environment to emerge. However, in paragraphs 7.351 to 7.416 of the January 2008 consultation we set out why we proposed to find that BT still had SMP in this market.

8.318 In the absence of regulation, we argued, BT would be able to further exploit its market power by restricting access to its network and leveraging its market power into the downstream market, thus reducing end users access to a choice of competitive services and prices. We considered therefore that the option of no regulation would poorly serve our objectives and, in particular, the promotion of competition in downstream markets for the benefit of end users.

- 8.319 Having found that the current regime has had limited success in promoting competition in the provision of trunk segments, we considered how the regulatory framework might be improved.
- 8.320 We considered that a cost orientation obligation alone may be insufficient to protect consumers from very high prices. We therefore considered that a charge control may be appropriate and are consulting separately on that.
- 8.321 With respect to other variations we proposed to adopt, the arguments set out in relation to some of the issues identified in the review of the low bandwidth TISBO market also apply to trunk services. In particular, at paragraph 8.52 and following we set out why we believe it is important that BT addresses the flaws in the PPC regulatory accounting regime and other obstacles to replicability identified by Ofcom, and why we believe we need to review the SLAs/SLGs regime. All these issues cut across terminating and trunk segments, and are therefore relevant here for considering the remedies we should impose on BT.

Conclusion on the choice of option

- 8.322 For the reasons discussed above, our preliminary conclusion was that the current regime required some changes if it is to further consumers' interests and promote competition in downstream markets. We therefore considered that the option of keeping the current framework unaltered would not therefore serve well our policy objectives.
- 8.323 However, we considered that the set of remedies we should impose should include the current obligations in relation to the provision of regulated access at non discriminatory terms and conditions. If competition is to flourish, BT should still be required to provide access at regulated and transparent terms and conditions, given the ubiquity of its infrastructures compared with that of its rivals. Rather, we argued, we needed to fine tune the existing remedies and further consider the issue of how to best regulate trunk prices. We therefore suggested that we should adopt the following variations and additional measures:
- review the SLAs/SLGs regime; and
 - work with BT to address the obstacles to replicability, including the flaws in the regulatory accounting regime.
- 8.324 In addition, one of the key problems we had identified in relation to trunk segments related to the excessive return BT appeared to enjoy for these services. We therefore considered that it would be appropriate for Ofcom to further consider the imposition of charge controls covering trunk segments.
- 8.325 Finally, at paragraphs 8.280 to 8.282 of the January 2008 consultation we considered the impact on stakeholders of the different options. We concluded that the option of varying the existing regime with the proposed amendments would best further consumers' interests and promote competition, and that this option should form the basis for proposing regulatory obligations on BT.

Preliminary conclusions: proposed regulatory obligations

- 8.326 In paragraphs 8.283 to 8.295 of the January 2008 consultation we considered the appropriate remedies to impose on BT. In conclusion, we proposed that the following obligations should apply to BT:

- an obligation to provide Network Access;
- a requirement not to unduly discriminate;
- cost orientation;
- a requirement to publish a reference offer;
- an obligation to give 90 days notice of changes to prices, terms and conditions for existing services;
- an obligation to give 28 days notice of the introduction of prices, terms and conditions for new services;
- a requirement to provide quality of service information;
- requirement to notify technical information with 90 days notice; and
- obligations relating to requests for new network access.

8.327 In addition, we considered that Ofcom should consider further the imposition of charge controls, on which we would consult separately.

8.328 With respect to SLAs/SLGs, we proposed amending the current PPC Direction to reflect the work that is being done by the OTA and industry on KPIs and, once Ofcom's work on Ethernet SLAs/SLGs would be completed, aligning the SLGs in the PPC regime with that of the Ethernet regime. In addition, we committed to continue to work with BT and industry to address the remainder replicability problems identified in the review of replicability set out in Annex 13 of the January 2008 consultation.

8.329 In paragraph 8.297 of the January 2008 consultation we described how we thought the proposed remedies met the Communications Act tests. We have set out at the end of this sub Section the appropriate Communications Act tests in detail for each regulatory obligations we have concluded will apply to BT.

Responses to the consultations and Ofcom's response

Charge controls

8.330 Most respondents welcomed the proposal to further consider a charge control on trunk segments. Some OCPs suggested that new starting charges or retrospective controls should also apply.

8.331 BT opposed the imposition of a charge control on the grounds that (i) it would deter investment in competing infrastructure, and (ii) the overall returns on trunk and termination together are reasonable, such that an SMP finding would be unjustified.

8.332 With respect to BT's comments, Ofcom has reconsidered the evidence of its SMP finding on BT. In Section 7 we have concluded that BT has SMP in a national market for trunk segments of PPCs with a market share above 58%. We have also found that BT enjoys a very high return on capital employed (67%), and has maintained a uniform pricing structure across the country. The findings support our conclusion that BT has SMP in this market.

- 8.333 Having considered the responses, we remain of the view charge controls should be applied to the services provided by BT in this market, given BT's dominant position, the high returns it earns on trunk segments, and the fact that the market is not prospectively competitive (see paragraph 7.170). In the absence of a charge control, we consider there is a significant risk that BT could increase its charges above competitive levels, and that this could lead to higher prices in retail markets, to the detriment of consumers.

Review of proposals for remedies

- 8.334 We have reviewed our proposals for remedies having regard to all the responses and representations received and all the evidence available to us following the January 2008 consultation. Our original proposals were set out in full at paragraphs 8.283 to 8.297 of the January 2008 consultation, and a summary has been provided above.
- 8.335 We consider that the regulatory objectives and analysis of the appropriate regulatory obligations for this market are broadly the same as for the high bandwidth TISBO market in the UK excluding the CELA and the Hull area, as described in paragraphs 8.154 to 8.166 above. This market is large, with BT's (internal and external) revenues of £265m in 2007/08¹⁰³. Given the size of the market and BT's SMP position, there is scope for significant consumer harm if BT were not regulated. For the same reasons as for the high bandwidth TISBO market in the UK excluding the CELA and the Hull area, we consider it appropriate to impose a broadly similar set of remedies.
- 8.336 With regard to charge controls we are consulting separately on this subject. We note however that charge controls were not imposed by the 2003/04 Review in the hope that a competitive environment would emerge, but that some years later this has not happened.

Conclusions

- 8.337 Having considered all the responses to the consultations, and having reviewed all the evidence available to us, we conclude that the most appropriate remedies are as set out below. In reaching our decision we have taken account of the considerations described in paragraphs 8.8 to 8.25 above. The reasons for our conclusion are referred to in the paragraphs immediately above and are also set out in Sections 8.283 to 8.295 of the January 2008 consultation.
- 8.338 Using the powers conferred upon Ofcom under Sections 87 and 88, Ofcom has therefore decided to impose the following obligations on BT in the market for trunk segments, excluding the Hull area:
- a general obligation to provide network access on reasonable request; in particular, it will continue to be subject to the PPC Direction;
 - an obligation not to discriminate unduly;
 - an obligation to price products and services on a cost orientated basis;
 - cost accounting and financial reporting obligations;

¹⁰³ BT Regulatory Financial statement 2007/08,
<http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2008/Regulatoryfinancialstatements2008.htm>

- an obligation to publish a reference offer;
 - an obligation to give 90 days notice of changes to prices, terms and conditions for existing services;
 - an obligation to give 28 days notice of the introduction of prices, terms and conditions for new services;
 - an obligation to provide quality of service information;
 - an obligation to notify technical information with 90 days notice; and
 - obligations relating to requests for new network access.
- 8.339 We also consider that BT should in principle be subject to a charge control with respect to the services in this market, the scope and form of which is considered in a separate consultation published alongside this Statement.
- 8.340 With respect to the SLAs/SLGs regime that should apply to services in this market, Ofcom and the OTA have now completed the work referred to in the January 2008 consultation. We set out our decisions in relation to the future SLAs/SLGs regime in paragraph 8.481 and following later in this Section.
- 8.341 With respect to replicability, BT has recently written to inform us that it now considers that the remaining obstacles to replicability identified in the January 2008 consultation have been removed. In the next few months, we will work with BT and industry to assess BT's compliance with the replicability requirements. If this is confirmed, we could be more confident that in the future the regulatory obligations imposed on BT will be more effective than hitherto in promoting greater competition in downstream retail markets.
- 8.342 The obligations above will also apply to interconnection services in this market as discussed at paragraph 8.448 and following later in this Section.
- 8.343 One last issue to consider relates to the way the new market definition, based on the provision of terminating segments up to 56 newly defined aggregation nodes, relates to BT's Eol requirement set out in BT's Undertakings. Currently the boundaries for the Eol requirement are core nodes. Under the new market definition, BT will be required to provide in some cases inter Metro connectivity. In this review, we are not seeking to change the boundaries of the Eol requirement. As such Eol will continue to apply up to the current boundaries. Provided BT does continue to comply with its Undertakings, it will be up to BT how it chooses to discharge its obligation. Our preference would be to see Openreach continue to manage the whole wholesale Ethernet portfolio, and hence buy, where required, inter Metro connectivity from another part of BT.
- 8.344 In the remainder of this sub Section, we first set out how we believe the obligations we are imposing on BT meet the legal tests we are required to carry out under the Act. We then set out how we have taken into account the ERG Wholesale Leased Lines Common Position on remedies in setting what we believe is the appropriate level of obligations on BT in order to promote greater competition in the downstream retail market for low bandwidth TI leased lines.

Communications Act tests

Introduction

8.345 It is our view that the regulatory obligations we are imposing on BT comply with the requirements set out in the Act. In the paragraphs that follow, we first consider how we believe they comply with Section 87(1) of the Act. Secondly, we consider, as suggested by recital 27 of the Framework Directive, whether competition law remedies alone would suffice to address the concerns and competition problems we have identified, and give our reasons why we think it would not. We then set out, individually for each of the obligations we are imposing on BT, how we believe it meets the appropriate legal tests under Section 47(2) of the Act. Finally, We set out how we believe the cost orientation obligation we are imposing on BT meets the further test set out in Section 88 of the Act.

SMP Conditions are appropriate

8.346 Section 87(1) of the Act provides that, where Ofcom has made a determination that a person has SMP in the market reviewed, it must set such SMP conditions as it considers appropriate and as authorised by the Act. This implements Article 8 of the Access Directive.

8.347 Having considered all responses to the consultations and all evidence available to us, we have identified in Section 7 BT as having SMP in this market. For the reasons set out in paragraphs 8.283 to 8.295 of the January 2008 consultation, and referred to in paragraph 8.335 above, we believe it is appropriate to impose such conditions on BT in relation to the objective we have set out to achieve in this review for the trunk segments market in the UK. In particular, in relation to the promotion of greater competition in the downstream retail market, which, we consider, would bring substantial benefits to end users by increasing their access to a competitive choice of prices and providers.

8.348 Finally, when considering what should be the appropriate remedies, we have had regard to the considerations set out in paragraph 8.109 of this Section.

Reliance on Competition Law alone not sufficient

8.349 In Section 7, we have considered in detail, among other things, if ex ante regulation would suffice to remedy the lack of competition found in this market. The arguments discussed at paragraph 7.172 are also relevant here in concluding that Competition Law alone would not be sufficient to remedy the lack of competition found in the trunk segments market.

Tests under Section 47(2) of the Act

8.350 We set out in details in the table below how we think each remedy passes the relevant Communications Act tests. In particular, how we believe each obligation we are imposing on BT meets the tests set out in Section 47(2) of the Act, according to which each obligation must be:

- objectively justifiable in relation to the networks, services or facilities to which it relates;
- not such as to discriminate unduly against particular persons or a particular description of persons;

- proportionate to what the condition is intended to achieve; and
- in relation to what it is intended to achieve, transparent.

Table 8.14: Summary of Ofcom's reasons for believing that the test of Section 47 (2) of the Act is met for the obligations imposed on BT as a result of it having SMP in the market for trunk segments in the UK excluding the Hull area

<i>Is it objectively justifiable in relation to the networks, services and facilities which it relates?</i>	<i>Is it such as not to discriminate unduly against particular persons or a particular description of persons?</i>	<i>Is it proportionate to what the condition is intended to achieve?</i>	<i>In relation to what it is intended to achieve, is it transparent?</i>
Obligation to provide access			
<p>The obligation is objectively justifiable as, in the absence of this condition, BT might refuse to supply trunk segments, which would prevent effective competition in the retail market. By ensuring that OCPs can gain access to BT's wholesale trunk segments services on fair and reasonable terms, it will enable OCPs to compete in the retail leased lines market. By enabling OCPs to compete fairly with BT, it puts pressure on BT to reduce costs and so promotes efficiency, confers the greatest possible benefits on end-users and promotes effective and sustainable competition. Although the charge control conditions will, if imposed following our separate consultation, limit average charges, they will not in themselves require BT to supply trunk segments.</p>	<p>The obligation does not discriminate unduly as it applies only to operators which have SMP in the relevant market and which therefore would be able to, and would have an incentive to, distort competition by denying access on fair and reasonable terms.</p>	<p>The obligation is proportionate since BT is not required to provide access if the request is unreasonable and because Ofcom does not consider that other operators will install competing facilities to an extent to undermine BT's SMP. BT is already providing network access, which is therefore clearly feasible. In the absence of Ex-ante regulation, entry barriers and BT's SMP mean that competition might never become established.</p>	<p>The obligation is transparent since the condition has been drafted for maximum clarity and because the purpose of the obligation and the reasons for imposing it are clearly explained in this document.</p>

<i>Non discrimination</i>			
<p>The requirement is justified because otherwise BT, as a vertically integrated operator, would be able to distort competition by discriminating against its rivals to the benefit of its own (downstream) divisions, e.g. through charging other operators higher prices than it charges BT Retail. It also ensures that BT does not abuse its SMP position by charging excessive prices or offering inadequate quality of service to particular groups of customer and, via the retail market, to end users. The requirement therefore promotes competition and furthers the interests of consumers.</p>	<p>The requirement does not discriminate unduly as it applies only to operators who, by possessing SMP in the relevant market, would be able to, and would have an incentive to, distort competition by discriminating against competitors.</p>	<p>The requirement is proportionate in that only discrimination which is unduly is prohibited and because it is the least onerous obligation required to address this particular risk of harm to competition. Ex ante regulation is more effective than ex post competition law where, as here, entry barriers and SMP mean that otherwise, effective competition might never become established.</p>	<p>The requirement is transparent since the condition has been drafted for maximum clarity and because the purpose of the obligation and the reasons for imposing it are clearly explained in this document.</p>
<i>Cost orientation</i>			
<p>The requirement is justified because, although the charge control conditions will, if imposed following our separate consultation, limit average charges, they do not in themselves control the level of individual charges within a basket subject to an average charge control. In the absence of this condition, BT might set individual charges at excessively high or anti-competitively low levels within a</p>	<p>The requirement does not discriminate unduly as it applies only to operators who, by possessing SMP in the relevant market, would be able to, and would have an incentive to, distort competition by setting charges which are not based on costs.</p>	<p>The requirement is proportionate because, by taking into account costs, including an appropriate contribution to the recovery of common costs and a reasonable return on investment, the cost orientation condition allows BT's charges to be proportionate to the extent of BT's investment in the provision of the relevant services. Ex ante regulation is necessary for the reasons set out above.</p>	<p>The requirement is transparent since the condition has been drafted for maximum clarity and because the purpose and meaning of the obligation and the reasons for imposing it are clearly explained in this document.</p>

basket.			
<i>Transparency obligations</i>			
These obligations are justified in that they provide certainty to operators and prevent BT withholding information from customers and competitors, or misusing information in a way which could harm competition. In addition, they facilitate Ofcom's monitoring of compliance with the other obligations, notably the obligation not to unduly discriminate.	The obligations do not discriminate unduly as they apply only to operators who, by possessing SMP in the relevant market, would be able to, and would have an incentive to, exploit customers and distort competition by withholding or misusing information.	The obligations are proportionate as the information which BT is obliged to publish is necessary to enable OCPs to make effective use of the network access which BT is also required to provide. The transparency obligations therefore support the other conditions imposed to address BT's SMP in this market. Without this information, OCPs could be unable to compete fairly with BT.	The obligation is transparent since the condition has been drafted for maximum clarity and because the purpose and meaning of the obligation and the reasons for imposing it are clearly explained in this document.

Test under Section 88 of the Act

8.351 Section 88 of the Act, which implements Article 13 of the Access Directive, further requires that, when considering a cost orientation obligation, we are able to demonstrate that:

- there is a risk of adverse effect from price distortion; and
- that the cost orientation obligation is appropriate to: promote efficiency, promote sustainable competition, and conferring the greatest possible benefits on end-users.

8.352 Paragraph (3) of Section 88 further argues that there is a relevant risk of adverse effects arising from price distortion if the dominant provider might:

- So fix and maintain some or all of its prices at an excessively high level, or
- So impose a price squeeze, as to have adverse consequences for end-users of public electronic communications services.

8.353 As discussed in Section 7, where we assessed SMP in this market, it appears from the market analysis that there is a relevant risk of adverse effects arising from price distortion. In particular, we have identified the risk that BT, given its market power, could engage in price discrimination between its downstream arms and its competitors when granting access to its network. In addition, in Section 7 we have also found that BT could potentially be earning high returns from these services. We think therefore that without an obligation to orient prices to costs, BT could, given its scale and scope advantages, afford to price below cost to deter further entry and push competitors out of the market (i.e. margin squeeze). It could also price above cost, which would results in higher prices for end users in retail markets, given the reliance of the market on BTs' wholesale access services. Given that the dominant

provider might engage in such practices, we think that we have identified a relevant risk of adverse effects arising from price distortions ex Section 88(3).

8.354 It also appears that the setting of the condition is appropriate for the purposes of promoting efficiency, promoting sustainable competition and conferring the greatest possible benefits on the end-users of public electronic communications services. We set out why we think this condition is appropriate in paragraph 8.164 of the January 2008 consultation.

8.355 As required by Section 88(1)(b) of the Act, Ofcom considers that this obligation fulfils the following requirements:

- promotes efficiency, by promoting cost based pricing and efficient market entry; and
- confers the greatest possible benefits on the end-users by ensuring that providers competing for customers in the retail market are not exploited by BT setting unreasonable conditions in the wholesale market.

8.356 The cost orientation condition that Ofcom is imposing requires that, unless Ofcom directs otherwise, BT shall set all charges such that they are reasonably derived from the costs of provision based on a forward looking long run incremental cost approach and allowing an appropriate mark up for the recovery of common costs. If a charge were set below the long run incremental cost of supply, then some customers may buy that product when they would not have been prepared to pay the full long run incremental costs of providing it. This is likely to be inefficient and result in a loss for society as a whole. Moreover, such a low charge is likely to be inconsistent with promoting sustainable wholesale competition, because it could mean that an equally efficient competitor is prevented from entering the market because it is unable to recover its incremental costs. By promoting efficiency and ensuring that competition is not distorted, requiring charges not to be below long run incremental costs will tend to confer the greatest benefits on end users. If a charge were above long run incremental costs plus an appropriate mark up, then it is higher than it needs to be in order to produce the service and this is unlikely to be in consumers' interests. If there were particular circumstances that mean that a charge set on the basis of long run incremental costs plus an appropriate mark up would not be appropriate, and would be detrimental to consumers' interests, then the condition allows Ofcom to direct that the charges are not required to be set on that basis.

Account taken of the ERG Wholesale Leased Lines Common Position

8.357 In accordance with ERG's Statement of 12 October 2006¹⁰⁴, while ERG Common Positions are not binding, ERG members must take the utmost account of them. Table 8.15 below summarises how Ofcom has taken into account the ERG WLL CP in proposing the regulatory remedies for this market.

Table 8.15 Account taken of the ERG Wholesale Leased Lines Common Position

Objective of remedy	Account taken by Ofcom
Assurance of supply	The requirement to provide Network Access on reasonable request should provide competitors with reasonable certainty of ongoing supply of wholesale leased lines in

¹⁰⁴ ERG(06)51.

	order to give them confidence to enter the market.
Level playing field	The requirement not to unduly discriminate, together with the Discrimination Guidelines, should ensure that entrants will be able to compete on a level playing field.
Avoidance of unfair first-mover advantage	The requirement not to unduly discriminate, together with the Discrimination Guidelines, should ensure that there is no unfair first-mover advantage.
Transparency of terms and conditions	The requirement to publish a Reference Offer and the requirement to notify charges, terms and conditions in advance should provide clarity of terms and conditions of wholesale leased lines.
Reasonableness of technical parameters of access	The requirement to publish a Reference Offer and the requirement to publish technical information and the obligation relating to request for new network access should ensure that the technical parameters of access are reasonable. In addition, the obligation to provide certain interconnection services should provide competitors with the ability to interconnect efficiently and economically at a wide range of locations for the purpose of wholesale leased lines interconnection.
Fair and coherent access pricing	The cost orientation obligation and the obligation to comply with charge controls should guarantee competitors that prices for wholesale leased lines is coherent with other services and gives the appropriate incentives for efficient investment decisions to both the SMP operator and its competitors.
Reasonable quality of access products	The proposed revisions of the SLAs/SLGs regime for PPCs should deliver a much improved framework for dealing with the quality of the services provided by BT to its competitors.

Retail market for low bandwidth leased lines in the UK excluding the Hull area

Introduction

8.358 In this sub Section, we set out the regulatory obligations that are being imposed on BT as a result of our finding that it has SMP in the provision of retail analogue and digital low bandwidth TI leased lines in the UK.

8.359 We first provide a summary of the proposals set out in the January 2008 consultation, which include a summary of the assessment of the appropriate policy options and remedies. Secondly, we review the responses to the consultations, providing our response to the issues raised. Thirdly, we review the choice of the appropriate remedies, having regard to all the responses and all available evidence. We then set out our conclusions and the remedies we have decided to impose on BT.

8.360 The last part of this sub Section sets out how we believe our obligations comply with the relevant tests in the Act.

Summary of proposals

8.361 In paragraphs 7.38 to 7.155 of the January 2008 consultation we set out our proposals in support of the finding of SMP for BT in this market. We have now confirmed this finding in Section 7 above. In the table below, we set out the key findings in support of our view.

Table 8.16 Key market power indicators

	Analogue and low bandwidth digital TI retail leased lines market
Market Share	89% (was 78% in the 2003/04 Review)
Profitability	Substantially above the level that competition authorities have usually found should apply in effectively competitive markets
<i>Qualitative indicators</i>	
BT's control of infrastructure and the fact that such infrastructure is not easily duplicated	
BT's ability to exploit economies of scale and scope, also as a result of its vertical integration	
The existence of significant barriers to entry and expansion	

8.362 In paragraphs 8.298 to 8.358 of the January 2008 consultation we then reviewed the regulatory options available to us, identified which option we believed would most appropriately serve our policy objectives, and which remedies, if any, should apply to BT in relation to its proposed SMP determination in the provision of analogue and digital low bandwidth TI retail leased lines in the UK excluding the Hull area. We present a summary of that assessment in the following paragraphs.

Options assessment

8.363 Before setting out our analysis of appropriate remedies, we considered our broader policy options and how best we could meet our policy objectives considering BT's SMP finding. In particular, we looked at how best we could further consumer interests by promoting more competition in this market, in which BT has a market share of 80%. We considered two main policy options, namely keeping the existing regulation or varying it to address the shortcoming we had identified, against the counterfactual of not imposing any regulation at all.

8.364 In particular, in the January 2008 consultation, paragraphs 8.301 to 8.337, we considered the following regulatory options:

- *No regulation*;
- *Status quo*, which means to continue to regulate BT's provision of analogue and low bandwidth digital TI retail leased lines in the UK, with the same SMP Conditions as set out in the 2003/04 Review; and
- *Variations and additional measures*, including: considering whether the existing service provision obligation is still necessary in view of the fact that the USD no longer requires the provision of the Minimum Set of Leased Lines; and seeking

voluntary undertakings from BT as an alternative to formal regulation, as it was done in the 2003/04 Review.

- 8.365 For each option, we considered how well it would serve our policy objectives, how it would affect the development of competition, and the impact it would have on the various key stakeholders, including BT.
- 8.366 Firstly, we considered whether we could withdraw regulation from the retail market and rely on the remedies at the wholesale level to foster competition. However, we believed that it would be premature to do so at present, for two main reasons:
- As the SMP analysis had shown, BT has a position of entrenched dominance in this market, with a persistently high market share which has increased since the last market review; and
 - Ofcom's April 2006 statement on replicability concluded that the services provided by BT in this market are not yet technically and commercially replicable by its competitors. The statement identified a number of issues which BT had to address before the services could be considered replicable, and before steps towards deregulation could be taken. We further considered the issue of Replicability in Annex 13 to the January 2008 consultation, where we concluded that, while BT had made some progress to address the deficiencies identified in the April 2006 statement on replicability, there were still a number of outstanding issues to be addressed before replicability could be considered to be achieved.
- 8.367 We did not consider therefore that the wholesale remedies applied in the related upstream market had been sufficiently effective to warrant deregulation of the retail market. If the existing SMP obligations were to be removed, we argued, there would be a risk that BT would be able to use its market position to restrict competition in the retail market either (i) by discriminating in favour of its own retail arm when supplying wholesale inputs and/or (ii) through price discrimination in the retail market, discounting where competition is strong and increasing prices where competition is weak. It was also possible that BT would cease to provide some of the legacy services in this market (such as analogue leased lines) prematurely, in order to force customers to migrate to newer and more profitable services. Outcomes of this sort, we concluded, would not be in the interests of citizens and consumers.
- 8.368 For these reasons, we proposed to reject the no regulation option. We did, however, believe that it would be appropriate to apply a sunset clause to the SMP obligations imposed in this market, to reflect our view that the development of more effective wholesale remedies would in due course make it unnecessary to apply ex ante regulation at the retail level.
- 8.369 Secondly, when considering whether to maintain the status quo, we concluded that the remedies in place were broadly appropriate. Rather, we considered that the problems identified in relation to the existing upstream remedies through the replicability analysis referred to above had meant that it has been the way that the upstream remedies have been implemented that have constrained the development of competition in this market.
- 8.370 We considered two possible variations to the existing regime. Firstly, when considering whether it would be appropriate to keep the service provision obligations in place on BT in this market, we concluded that it would be for some but not all services and, in particular, for:

- New and existing supply of 2 Mbit/s, which remains one of the key services in leased lines markets in the UK; and
- The existing installed base of analogue and digital circuits of speeds up to 2 Mbit/s.

8.371 We further considered that, given the steady decrease in volumes for the latter services over recent years, it would be more appropriate and proportionate to seek to ensure supply by means other than formal regulation. We therefore sought a voluntary undertaking from BT on the supply of analogue and low bandwidth digital circuits of speeds up to 2 Mbit/s. In addition, we asked BT for a voluntary undertaking on the price of analogue services which, unlike digital leased lines, do not have a corresponding upstream remedy designed to support downstream competition. Overall, we considered that an approach based on co-regulation would align with Ofcom's statutory duty to reduce the burden of regulation where possible. In addition, the successful experience with a similar approach from the 2003/04 Review supported our view that such an approach would be effective in dealing with the problems identified in relation to the supply and pricing of analogue services and the supply of low bandwidth digital circuits at speeds up to 2 Mbit/s.

Preliminary conclusions and proposed remedies on BT

8.372 For the reasons set out in summary above, our preliminary conclusion was that a regime based broadly on the current obligations, together with a set of voluntary undertakings from BT, would be the most appropriate option. We proposed that the following obligations should apply on BT:

- **Obligation to provide:** BT should be required to supply existing and new 2 Mbit/s retail low bandwidth leased lines to third parties on reasonable request. The supply of analogue and low bandwidth digital up to 2 Mbit/s should be addressed through a voluntary undertaking, as set out below;
- **No undue discrimination:** For all analogue and digital services at speeds up to and including 8 Mbit/s, a requirement not to unduly discriminate; and
- **Obligation to publish a Reference offer:** For all analogue and digital services of speed up to and including 2 Mbit/s, a requirement to publish prices, terms and conditions, and to notify on the same day of entering into force any changes to those prices terms and conditions.

8.373 In addition, we proposed to accept the following voluntary undertakings from BT:

- that it will continue to supply new analogue retail circuits until 2011 or earlier if, subject to industry agreement and consent by Ofcom, the underlying platform is closed at an earlier date;
- that it will continue to supply new sub-2Mbit/s retail circuits until 2011 or earlier if, subject to industry agreement and consent by Ofcom, the underlying wholesale products are withdrawn from new supply at an earlier date;
- that it will not increase its prices for analogue services more quickly than the rate of inflation (RPI-0%) for a period two years following the publication of the LLMR statement i.e. from 2008 to 2010; and

- that it will commit to a further two-year cap, the level of which would be agreed with Ofcom prior to 2011.
- 8.374 We proposed that a conditional cost orientation obligation in relation to the price of analogue services should apply to BT if it should fail to adhere to its pricing commitment, or if BT and Ofcom should fail to reach agreement on a further two-year cap from 2011. The cost orientation condition would require BT charges for analogue circuits to be derived from LRIC, plus a reasonable contribution to fixed common costs.
- 8.375 Finally, we proposed that a sunset clause should apply, under which these obligations would apply for a fixed period of four years from the implementation of the new regulatory framework. Unless a further market review has been completed during that time, we argued, the obligations should fall away at the end of the four year period.
- 8.376 In paragraph 8.358 of the January 2008 consultation we described how we thought the proposed remedies met the Communications Act tests. We have set out at the end of this sub Section the appropriate Communications Act tests in detail for each of the regulatory obligations we have concluded will apply to BT.

Responses to the consultations and Ofcom's response

Retail regulation

- 8.377 BT argued in its response that, in its view, ongoing retail regulation is inconsistent with fundamental regulatory principles. They argued that SMP remedies at the retail level are contrary to Ofcom's principle of focusing regulation on identified upstream problems around market access, that it is against the Undertakings, and that it contrasts with the EU Framework.
- 8.378 We have considered BT's comments, but have found in the SMP assessment sufficient causes of concern to warrant some level of regulation in the retail low bandwidth leased lines market, especially for analogue and low bandwidth digital leased lines. We do not believe that our approach is inconsistent with Ofcom's regulatory principles or with the regulatory framework within which we operate. In particular, we have sought to balance our duty to regulate where SMP is found with our duty to deregulate, where market conditions warrant it. Our approach is based on accepting voluntary undertakings from BT instead of more formal obligations. In addition, the Commission, in its comments to our Notification for these markets, has broadly accepted our arguments to continue to define this market for the purpose of SMP assessment and the imposition of remedies.
- 8.379 We consider that, in imposing retail remedies on BT, we have complied with the requirements of the Act. We set out at the end of this sub Section the arguments on which this view is based.

Replicability

- 8.380 BT argued in its response that most replicability issues have been resolved, and that full replicability is likely to be achieved in the near future. BT argued therefore that, as this is the case, it would be disproportionate for Ofcom to impose regulation for a further four years.

- 8.381 BT's response to the replicability discussion in Ofcom's consultation document can be summarised as follows:
- A finding of replicability in respect of retail low bandwidth TI PPCs means that SMP regulation in the retail low bandwidth TI market is not justified; and
 - Sufficient progress has been made in regard of the barriers identified in the Replicability Statement that Ofcom should consult now on a finding of replicability.
- 8.382 Ofcom believes that such a position is incompatible both with the market review process and with the replicability process as described in the Replicability Statement and applied in respect of WLR in Ofcom's consent *Replicability: the regulation of BT's retail business exchange line services* published on 29 May 2007¹⁰⁵ (the WLR Replicability Consent).
- 8.383 As stated above, and as described in both the Replicability Statement and the WLR Replicability Consent, a finding of replicability does not imply the removal of SMP regulation. Instead a finding of replicability is intended to lead to the publication of a consent for BT to relax certain obligations in respect of pricing transparency and non-discrimination but leaves other regulations in place. This is important for two reasons. Firstly, that the replicability process is not as rigorous as a market review and is therefore an inappropriate mechanism for determining if SMP regulation should be removed. Second the concept of replicability is, as Ofcom stated in the Replicability Statement, an on-going one and if it is subsequently found that replicability is no longer possible then the consent can be suspended in which case the SMP obligations will be re-asserted. This is important as SMP regulation is designed to prevent the abuse of market power whereas replicability is not.
- 8.384 Further, Ofcom stated that the consent would only be given initially in respect of those customers spending in excess of £1m annually with BT on communications services. This was seen by Ofcom as necessary since the granting of the consent would make it much harder to monitor BT for compliance with relevant competition legislation. To ensure that ex post compliance could still be assessed, for example during an investigation, Ofcom required BT to maintain records relating to contracts won under the consent. We believed that at least initially the consent should be restricted to high value accounts as it is more likely that such accounts have sufficient senior management oversight to ensure that such record keeping requirements are adhered to. Only after a period during which Ofcom could be satisfied that the record keeping is effective would we consider extending the consent to other, smaller business accounts. This is the approach that was followed in the WLR Replicability Consent which currently still has the restriction to high value accounts in place. To adopt an alternative approach in respect of PPCs would be inconsistent and would set a precedent for any future consideration of CPS replicability which has yet to be assessed.
- 8.385 BT asserted that Ofcom should have initiated the process to consult on replicability with respect to PPCs as BT believed it had removed many barriers and in the case of the remainder ones it had firm plans to remove those.
- 8.386 BT has followed up in September 2008 with a letter stating it is now in compliance with respect to the remainder replicability issues. We therefore intend to consider this issue again in the near future and work with the industry in the months to come to

¹⁰⁵ <http://www.ofcom.org.uk/consult/condocs/draftconsent/statement/>

ensure that BT's assessment that it now complies with all replicability requirements is correct. We will consult separately on this matter once we have reviewed BT's evidence in support of its Statement, and intend to consider at that stage the appropriate level of deregulation that Ofcom might confer to BT following the achievement of replicability.

Sunset clauses attached to SMP conditions

- 8.387 Several respondents, including UKCTA, stated that there should be no sunset clauses attached to SMP conditions, and that remedies should not lapse without a market review within four years.
- 8.388 The European Commission also stated that Ofcom should review the market before the four year period proposed for the remedies expires.
- 8.389 We considered at the time of the January 2008 consultation that the problems identified in this market which require continued regulation would largely be resolved. In particular, that there'll be a substantial migration away from legacy analogue and TDM services, reducing the risk of consumer's harm through service withdrawal. In addition, BT has now stated that it will continue to support legacy services until 2014, which gives plenty of time for the industry to engineer a solution to migrate users onto BT's NGN after 2014, or find an alternative solution. In addition, we considered that the replicability issues would also be resolved within four years, making the wholesale remedies more effective and increasing the chances of downstream retail competition in the future. We wanted therefore to have a mechanism to reduce retail regulation automatically in four years time, without the need to review the market.
- 8.390 We have considered the respondents comments, and reviewed the objectives of this proposal. In view of those comments, we consider that allowing SMP obligation to expire automatically without a review of the market conditions might not necessarily be in the best interest of end users. Having also regard for the fact that, considering the use of voluntary undertakings for the supply and pricing of certain analogue and digital low bandwidth services, and provided BT complies with such undertakings, the remainder SMP obligations on BT will be limited to an obligation to provide 2 Mbit/s, a no undue discrimination obligation, and obligation to publish a reference offer, we consider that a better solution will be in the future to consider the dis-application of the remainder remedies if the circumstances emerge that would make them no longer appropriate or necessary. This also seems to be an appropriate solution in the light of BT's claims that it has now achieved replicability. The sunset clause will therefore not apply.

Price controls

- 8.391 One respondent suggested that the proposed price control for analogue services should be extended to include all low bandwidth retail leased lines, which are legacy services with little prospect of migration.
- 8.392 Ofcom points to the fact that it proposed to accept a voluntary undertaking on BT on the pricing of analogue services, and not to impose a price control. The option of a charge control was discussed in the assessment of the regulatory options, at paragraph 8.301 and following of the January 2008 consultation. We believe that our

assessment that voluntary undertakings represent a better option than formal price controls for this market is still valid.

Requirements of the energy industry

- 8.393 The ENA said that Ofcom's proposals for analogue and sub-2Mbit/s digital services went some way to addressing the energy utilities concerns about short term service continuity but was concerned about how the energy utilities requirements for low-bandwidth circuits with low-latency would be met in the medium to long term.
- 8.394 The ENA said that in order to meet the energy utilities requirements, Ofcom would need to require BT to supply leased lines conforming to the utilities technical requirements for at least 20 years.
- 8.395 The ENA were also concerned about recent rises in the price of BT Kilostream circuits and asked Ofcom to secure a voluntary agreement from BT not to raise prices above the RPI.
- 8.396 Given the pace of technological change in the leased line market, it would not be appropriate for Ofcom to place BT under a very long term requirement (such as the 20 year period suggested) to provide circuits to ENA technical specifications.
- 8.397 As discussed in the consultation, Ofcom considers that its proposals strike a balance between the aim of encouraging BT's investment in new, more efficient network infrastructure and the aim of ensuring continuity for retail customers such as the energy utilities.
- 8.398 Ofcom considers that the ENA's concerns about Kilostream prices would be adequately addressed by the voluntary undertakings given by BT on the pricing and supply of analogue and sub-2Mbit/sec digital services.

Review of proposals for remedies

- 8.399 The January 2008 consultation set out our proposals at paragraphs 8.338 to 8.357, and a summary has been provided in paragraphs 8.372 to 8.375 above. In the following paragraphs, we review our proposals having regard to all responses and representations received and all evidence available to us following the consultations of January and July 2008.
- 8.400 We then complete our review for this market by setting out our final decisions on the regulatory obligations that should apply to BT.

Aims of regulation and considerations in design of remedies

- 8.401 We set out our policy objectives in paragraphs 8.33 to 8.37 of the January 2008 consultation. Given that we have found in Section 7 that BT has SMP in this retail market, we consider that regulation should have the following aims in this market:
- to protect consumers from the exploitation of that SMP, for example to protect them from excessive prices; and
 - to promote competition in the retail market for analogue and low bandwidth digital TI leased lines.

- 8.402 In assessing the appropriateness of regulatory remedies Ofcom has particularly taken into account paragraphs 21 and 114 of the Commission's SMP Guidelines which state that NRAs must impose one or more appropriate SMP services conditions on a dominant provider, and that in the view of the Commission it would be inconsistent with the objectives of the Framework Directive not to impose any SMP services conditions on an undertaking which has SMP.
- 8.403 We have also had regard to the requirements of Section 91 of the Act mentioned at paragraph 8.26 in this Section. We set out later in this sub Section our arguments in support of the passing of such test as referred to in Section 91(2) of the Act.
- 8.404 In considering what the appropriate remedies might be, we have taken into consideration Section 91(5) and (6) of the Act. Section 91(5) states that *"The SMP conditions authorised by this Section are conditions imposing on the dominant provider such regulatory controls as OFCOM may from time to time direct in relation to the provision by that provider of any public electronic communications service to the end-users of that service."*
- 8.405 Further, Section 91(6) states that *"Where OFCOM set a condition which is authorised by this Section and imposes regulatory control on tariffs or other matters to which costs are relevant, they shall also set, and apply to the dominant provider, an SMP condition which requires him, to the extent that they consider it appropriate— (a) to use such cost accounting systems as may be determined by them; (b) to have the use of those systems audited annually by a qualified auditor; and (c) to publish an annual statement about compliance by the dominant provider with the obligations imposed by virtue of paragraph (a)."*
- 8.406 We have considered above the stakeholders comments in relation to our proposals for this market. After setting out our response to the issues raised, we consider that the arguments and evidence in support of our proposals has not changed. We have taken on board the comments in relation to the sunset clause proposal, and have modified our final decision accordingly.
- 8.407 We believe that the analysis of what precise remedies should apply as set out in 8.338 to 8.357 of the January 2008 consultation still applies. We review the justification for the remedies in the following paragraphs. In doing this, we have divided the specific conditions into the following four categories:
- obligation to supply;
 - requirement not to unduly discriminate;
 - cost orientation; and
 - requirement to publish a reference offer.

Obligation to supply

- 8.408 As discussed in paragraphs 8.314 to 8.322 of the January 2008 consultation, to further consumers' interests, we consider BT should continue to support the installed base of analogue and digital leased lines at speeds up to and including 2Mbit/s. BT should be obliged to supply existing and new 2Mbit/s services to third parties on reasonable request. The provision of analogue and sub-2Mbit/s services is addressed by the voluntary undertaking.

Requirement not to unduly discriminate

- 8.409 The 2003/04 Review imposed an obligation on BT not to discriminate unduly in the provision of low bandwidth retail leased lines, including analogue and digital circuits of speeds up to and including 8 Mbit/s. In this review, BT has been found to still have SMP in this market and, as outlined in the April 2006 replicability statement, Ofcom does not consider it possible at present for BT's competitors to replicate effectively BT's retail low bandwidth leased line services. The remedies currently applied in the wholesale market for low bandwidth TISBOs and trunk segments have not been sufficient to ensure that BT's competitors can compete effectively in the downstream retail market. In these circumstances, Ofcom considers it is still appropriate to require BT not to unduly discriminate in the provision of retail low bandwidth leased lines products.
- 8.410 Ofcom considers that application of a non discrimination condition should not prevent BT from setting geographically de-averaged tariffs i.e. charging different prices for retail leased lines at different locations (as it does currently for the Central London Zone (CLZ), provided that in doing so it does not discriminate between customers or have a material adverse effect on competition.
- 8.411 As discussed above, Ofcom proposes that, in applying the proposed condition, there should be a presumption that saw-tooth discounts are unduly discriminatory.

Cost orientation

- 8.412 In the 2003/04 Review, Ofcom was obliged by the provisions of the USD to consider whether it was appropriate to impose cost orientation for analogue and digital leased lines of speeds up to and including 2 Mbit/s.
- 8.413 At that time we concluded that this obligation should be imposed on BT, but that they should only come into effect if BT breached its voluntary undertaking on the pricing of analogue circuits. We have decided to adopt a similar approach in the present review.
- 8.414 Specifically, the cost orientation condition will require the costs of analogue circuits to be reasonably derived from the Long Run Incremental Costs of service provision, allowing an appropriate mark-up for the recovery of common costs and including an appropriate return on capital employed.
- 8.415 This condition would only come into effect if:
- BT breaches its voluntary undertaking for 2008-10 on the pricing of analogue circuits; or
 - BT and Ofcom fail to reach agreement on a voluntary undertaking to apply in 2010-2012.
- 8.416 Ofcom does not consider it necessary to apply a cost orientation requirement to low bandwidth digital circuits at bandwidths up to and including 2Mbit/s, because we have already set a cost orientation obligation for the wholesale inputs used in their provision, and we are consulting separately on a charge control. We, therefore, consider that the regulation set at the wholesale level will be sufficient to allow Ofcom to perform its duties under Section 4 of the Act. Further retail regulation in this particular respect is, thus, not required.

- 8.417 Ofcom also believes that it would be disproportionate to apply a cost orientation requirement to 8Mbit/s circuits in the retail market, as very few of these circuits remain in service.

Requirement to publish a reference offer (setting out prices, terms and conditions) and same day price notification

- 8.418 Currently BT is subject to an obligation to publish prices, terms and conditions, and to notify changes to those. This obligation was required by the USD provisions for the Minimum Set of Leased Lines, which have now been withdrawn.
- 8.419 The publication provision has had an important role in the regulation of BT's activities in this market because it has provided transparency over pricing. In conjunction with the non-discrimination obligation, the effect has been to prevent BT from bundling low bandwidth leased lines together with other, non-SMP, services and from offering bespoke prices in order to secure business contracts against competition from other CPs.
- 8.420 The issues related to bundling and bespoke pricing were considered in detail in Ofcom's April 2006 statement on Replicability. Ofcom's conclusion at that time was that, until BT's retail services are effectively replicable by its competitors, the current restrictions on bundling and bespoke pricing should remain. BT's low bandwidth leased line services were not considered replicable at that time for a variety of reasons set out in the statement.
- 8.421 Since the April 2006 statement, we understand that BT has made progress in addressing some of the barriers to replicability identified by Ofcom, but that a number of issues have still to be resolved. In these circumstances, it would be premature to consult on whether replicability has now been achieved, and whether the SMP regulations which apply in this market should therefore be relaxed.
- 8.422 Ofcom's intention is to return to this issue as and when BT has presented evidence that all of the issues identified in the replicability statement have been resolved. If our initial review of the evidence suggests that BT's services may now be replicable, we will then consult on whether replicability has been achieved, and whether the regulations should therefore be relaxed.
- 8.423 For the present, however, and in view of the continued SMP position of BT in this market, Ofcom considers that the current publication requirements should continue to apply.

Conclusions

- 8.424 Having considered all responses to the consultations, and having reviewed all evidence available to us, we think that both the assessment of the most appropriate policy option and that of the appropriate remedies as set out in the January 2008 consultation remain appropriate. A summary of that assessment has been provided at paragraph 8.408 and following in this Section.
- 8.425 In setting out the appropriate obligations that will apply to BT, we have had regard for the requirements of the Act, and, in particular, Sections 45-50 and 87-92, which set out the regulatory obligations that Ofcom can impose if it finds that any undertaking has SMP. Sections 87-92 of the Act implement Articles 9 to 13 of the Access directive and Articles 17 to 19 of the Universal Service Directive.

- 8.426 We consider therefore that it is appropriate for Ofcom to impose the proposed obligations discussed at paragraph 8.372 and following in this Section for the reasons discussed at paragraphs 8.408 and following of this Section.
- 8.427 Using the powers conferred upon Ofcom under Sections 87 and 88, Ofcom has therefore decided to impose the following obligations on BT in the market for retail analogue and low bandwidth digital leased lines in the UK, excluding the Hull area:
- **Obligation to provide:** BT should be required to supply existing and new 2 Mbit/s retail low bandwidth leased lines to third parties on reasonable request. The supply of analogue and low bandwidth digital up to 2 Mbit/s should be addressed through a voluntary undertaking, as referred to below;
 - **No undue discrimination:** For all analogue and digital services at speeds up to and including 8 Mbit/s, a requirement not to unduly discriminate; and
 - **Obligation to publish a Reference offer:** For all analogue and digital services of speed up to and including 2 Mbit/s, a requirement to publish prices, terms and conditions, and to notify on the same day of entering into force any changes to those prices terms and conditions.
- 8.428 In addition, we also accept the following voluntary undertakings from BT¹⁰⁶:
- that it will continue to supply new analogue retail circuits until 1 January 2011 or earlier if, subject to industry agreement and consent by Ofcom, the underlying platform is closed at an earlier date;
 - that it will continue to supply new sub-2Mbit/s retail circuits until 1 January 2011 or earlier if, subject to industry agreement and consent by Ofcom, the underlying wholesale products are withdrawn from new supply at an earlier date;
 - that it will not increase its prices for analogue services more quickly than the rate of inflation (RPI-0%) for a period two years following the publication of the Business Connectivity Market Review Statement i.e. from 2008 to 2010; and
 - that it will commit to a further two-year cap, the level of which would be agreed with Ofcom prior to 2011.
- 8.429 We proposed that a conditional cost orientation obligation in relation to the price of analogue services should apply to BT if it would fail to adhere to its pricing commitment, or if BT and Ofcom should fail to reach agreement on the two-year cap for 2012. The cost orientation condition would require BT charges for analogue circuits to be derived from LRIC, plus a reasonable contribution to fixed common costs.

Communications Act tests

Introduction

- 8.430 It is our view that the regulatory obligations we are imposing on BT comply with the requirements set out in the Act. In the paragraphs that follow, we first consider how we believe they comply with Section 87(1) of the Act. Secondly, we consider, as

¹⁰⁶ Annex 9 presents the letter with the voluntary undertakings Ofcom has received from BT.

suggested by recital 27 of the Framework Directive, whether competition law remedies alone would suffice to address the concerns and competition problems we have identified, and give our reasons why we think it would not. We then set out, individually for each of the obligations we are imposing on BT, how we believe it meets the appropriate legal tests under Section 47(2) of the Act. Finally, We set out how we believe the cost orientation obligation we are imposing on BT meets the further test set out in Section 88 of the Act.

SMP Conditions are appropriate

- 8.431 Section 87(1) of the Act provides that, where Ofcom has made a determination that a person has SMP in the market reviewed, it must set such SMP conditions as it considers appropriate and as authorised by the Act. This implements Article 8 of the Access Directive.
- 8.432 Having considered all responses to the consultations and all evidence available to us, we have identified in Section 7 BT as having SMP in this market. In the light of the assessment of the costs and benefits of addressing the SMP through the remedies considered earlier in this Section, we have concluded that BT shall be subject to the obligations set out at paragraph 1.72 and following in this Section.
- 8.433 For the reasons set out in paragraphs 8.338 to 8.407 of the January 2008 consultation, and reviewed at paragraph 8.408 and following in this Section, we believe it is appropriate to impose such conditions on BT in relation to the objective we have set out to achieve in this review for the market for retail analogue and low digital bandwidth leased lines in the UK. In particular, in relation to the promotion of greater competition in the downstream retail market, which, we consider, would bring substantial benefits to end users by increasing their access to a competitive choice of prices and providers.
- 8.434 Finally, when considering what should be the appropriate remedies, we have had regard, as indicated in paragraph 8.109 of this Section, to a set of Guidelines from Oftel/Ofcom which identify a range of appropriate remedies that can be imposed when there is a finding of SMP in an electronic communications market.

Reliance on Competition Law alone not sufficient

- 8.435 Ofcom considers that ex ante retail regulation provides a more efficient means of securing effective competition in the retail market, as against the option of solely relying on the application of ex post competition law.
- 8.436 If the proposed SMP retail obligations were to be removed, there is a very real risk that BT would restrict competition in the retail market through price discrimination i.e. discounting where competition is strong and increasing prices where competition is weak. It is also possible that BT would cease to provide some legacy services in the retail market (such as analogue leased lines) prematurely, as discussed in paragraphs 8.314 to 8.322 of the January 2008 consultation. Absent ex ante regulatory intervention, there is a real risk that BT's conduct would depart substantially and persistently from that which would be desirable. A further consideration in the case of analogue services is that there is no ex ante wholesale remedy for these services (i.e. these services are not provided to other Communications Providers on a wholesale basis by BT). While analogue users currently have the ability to switch to retail digital leased line services and so benefit from competition based on wholesale digital remedies, the discussion above makes clear that digital services themselves are not completely effective yet. Replicability

should therefore also benefit analogue users, who will in any event have migrated to these services by 2012.

- 8.437 Because it is almost certain that such conduct would harm consumers and the competitive process, Ofcom considers that it is more efficient to prohibit this conduct via ex ante regulation rather than to rely on an ex post regime which determines after the fact whether particular conduct is unacceptable. An ex ante approach is likely to create greater specification in advance, and is less costly to interpret and apply. Given its relative ease of administration and application, ex ante regulation will tend to encourage greater compliance. Equally, because of its greater clarity, ex ante regulation will mean that BT is likely to be deterred from engaging in behaviour that is prohibited by regulation.

Tests under Section 47(2) of the Act

- 8.438 We set out in details in the table below how we think each remedy passes the relevant Communications Act tests. In particular, how we believe each obligation we are imposing on BT meets the tests set out in Section 47(2) of the Act, according to which each obligation must be:

- objectively justifiable in relation to the networks, services or facilities to which it relates;
- not such as to discriminate unduly against particular persons or a particular description of persons;
- proportionate to what the condition is intended to achieve; and
- in relation to what it is intended to achieve, transparent.

Table 8.17: Summary of Ofcom's reasons for believing that the test of Section 47 (2) of the Act is met for the obligations imposed on BT as a result of it having SMP in the market for retail analogue and low bandwidth digital leased lines in the UK excluding the Hull area

<i>Is it objectively justifiable in relation to the networks, services and facilities which it relates?</i>	<i>Is it such as not to discriminate unduly against particular persons or a particular description of persons?</i>	<i>Is it proportionate to what the condition is intended to achieve?</i>	<i>In relation to what it is intended to achieve, is it transparent?</i>
Obligation to supply 2 Mbit/s			
The obligation is objectively justifiable as, in the absence of this condition, BT might refuse to supply analogue and low bandwidth digital (T1) leased lines in order to force suppliers to migrate to other BT services (notably A1 leased lines). It	The obligation does not discriminate unduly as it applies only to operators which have SMP in the relevant market and which therefore would be able to, and would have an incentive to, exploit customers by refusing to supply.	The obligation is proportionate since BT is not obliged to supply if the request is unreasonable and because the obligation does not apply to 8Mbit/s leased lines, or to the supply of new analogue and sub 2Mbit/s traditional interface digital circuits. It only requires BT to	The obligation is transparent since the condition has been drafted for maximum clarity and because the purpose of the obligation and the reasons for imposing it are clearly explained in this document.